

For the Tax Practitioner

**Summer 1996** 

Recently issued proposed regulations under IRC section 1441 would make significant revisions to the current system of withholding on, and reporting of, amounts paid to foreign persons. When finalized, the regulations are expected to streamline certification procedures by combining Forms W-8, 1001, 4224, and 8709 into a single Form W-8. More information about new procedures affecting foreign investors and their withholding agents follows in this issue of the Forum.

After Congress passes laws that become part of the Internal Revenue Code, the IRS writes regulations that help to interpret and apply those laws. Before those regulations become final, they're generally issued in proposed form and published in the Federal Register. Anyone can comment on proposed regulations, and, in fact, you can even request to testify at a public hearing.

Since not everyone has ready access to the Federal Register, the IRS's home page (http://www.irs.ustreas.gov) now not only includes proposed regulations, but also provides a quick and easy way to comment on those regulations. The IRS reviews all comments and makes appropriate changes to the regulations before they become final.

Once a user is on the "Tax Regs in Plain English" page, the comments section is easy to get to — either by clicking on the "Comments on Proposed Regs" section on the front page, or the "Comments" line after each regulation description. Comments should be forwarded to the IRS within 90 days of publication of the proposed regulations. All such comments are made available for public inspection.

While we can't respond to each individual's comments, we can assure you that your input will be fully considered.

John T. Lyons

**Assistant Commissioner (International)** 

## Proposed NRA Withholding Regs Issued

Most payments of U.S. source income (not effectively connected with a U.S. trade or business) paid to a foreign person are subject to a 30-percent tax imposed on the gross amount. The Internal Revenue Code makes exceptions for investment-type interest — such as interest on bank deposits and Treasury or corporate bonds — and most capital gains. In addition, U.S. tax treaties typically reduce or eliminate the 30-percent tax.

When applicable, the tax is collected by way of withholding on the amount paid. Where the tax liability is satisfied at source, the foreign taxpayer is generally not required to file a tax return with the IRS. Instead, information about the payment and any amount withheld is reported to the IRS by the withholding agent who files an annual return (Form 1042) reporting the total amount of income paid and taxes withheld during the calendar year. The withholding agent must also file a form 1042-S reporting the total amount of income paid and tax withheld to each beneficial owner. In addition, the withholding agent must furnish a copy of the form to the owner of the income.

Under current rules, a withholding agent making a payment to a foreign person may generally rely on a statement furnished by, or on behalf of, the owner when asked to reduce the rate of withholding. Most statements are currently required to be made on a Form W-8, Certificate of Foreign Status, a Form 1001, Ownership, Exemption, or Reduced Rate Certificate, or Form 4224, Exemption from Withholding of Tax on Income Effectively Connected With the Conduct of a Trade or Business in the United States.

Recently issued proposed regulations under IRC section 1441 would streamline the statements that must be furnished to a withholding agent to claim a reduced rate of withholding by combining most forms into one, a Form W-8. This form, which is a certification by the beneficial owner signed under

penalties of perjury, requires the name of the beneficial owner, the permanent residence address (and, if different, the mailing address), and a taxpayer identification number (if any). The regulations would clarify that the permanent residence address on the form cannot be a P.O. box or an address in care of another person. They further require that the permanent residence address is a tax residence address.

Under current rules a taxpayer Identification Number (TIN) is required only if an exemption is claimed for effectively connected income. Under the proposed regulations, the TIN requirement would be extended to a limited number of transactions — generally dividends on non-publicly traded stocks and other types of income for which benefits are claimed under a tax treaty. The vast majority of transactions would continue to be exempt from having to furnish a TIN (e.g., portfolio interest on registered obligations, bank deposit interest, OID on short term obligations, broker proceeds, or dividends on publicly traded stocks). Under regulations proposed in 1995, however, a TIN would be required for taxpayers filing a tax return (other than an information return).

Other revisions proposed would:

- reduce the current burden on withholding agents by clarifying the type of due diligence expected from them;
- eliminate the "address rule" for dividends for which a benefit is claimed under a tax treaty;
- prescribe rules governing when and how qualified intermediaries can certify on behalf of a beneficial owner:
- provide relief for withholding on corporate distributions.

As proposed, the regulations would be effective for payments made after December 31, 1997. Written comments and request to speak at the public hearing should be received by July 22, 1996.

#### **ITIN Update**

As discussed in our Spring 1996 issue, the IRS will begin processing applications for the IRS Individual Taxpayer Identification Number (ITIN) in July. Beginning January 1, 1997, the IRS will require all persons, U.S. or foreign, who file a U.S. tax return to provide a valid TIN on their return. A valid TIN is defined as a Social Security Number (SSN), an Employer Identification Number (EIN), or the new ITIN.

IRS Form W-7, *Application for Individual Taxpayer Identification Number*, will be available from IRS offices in late June. Forms may also be obtained by calling the 1-800-TAX-FORM number, and by computer via the IRIS electronic bulletin board, with the modem number 703-321-8020 (not toll-free), or the IRS' "home page" on the Internet at http://www.irs.ustreas.gov.

Your client must have an ITIN if he or she is a non-U.S. individual who does not have and cannot obtain a Social Security Number, and meets any of the following conditions:

- required to file a U.S. tax return,
- claimed as a dependent of a U.S. person on his or her tax return,
- the spouse of a U.S. person who elects to file a joint U.S. tax return,
- claimed as a spouse for exemptions on a U.S. tax return, or
- filing a U.S. tax return only to claim a refund.

Your client does not need an ITIN if he or she:

- is a U.S. citizen, or
- already has or can obtain a Social Security Number.

ITINs are for tax purposes only and do not entitle the recipient to Social Security benefits. Also, please note that alien individuals who come to the U.S. with the Immigration and Naturalization Service's approval to work will continue to be entitled to receive a SSN.

## The 1996 Special Enrollment Exam

Persons, other than attorneys and CPAs, who wish to qualify to practice before the IRS must demonstrate technical competence in tax matters by successfully completing a four-part written examination given over a two-day period. This year's examinations will be offered on September 26 and 27, at IRS offices overseas, as well as at IRS district offices in the U.S. The fees are \$55 for all four parts and \$45 for less than four parts.

Due to budget constraints, Publication 1470, *Package for the Special Enrollment Examination*, was discontinued this year. Instead, prospective applicants will receive Form 2587, *Application for the Special Enrollment Examination*. This form may be ordered by calling 1-800-829-3676. Applicants living abroad may obtain Form 2587 from one of our overseas posts-of-duty.

The instruction to Form 2587 contain an order form to request exam study materials. The instructions also list the names, addresses, and phone numbers of four professional organizations that candidates may contact to obtain a free copy of the 1995 Special Enrollment Examination questions and answers.

We have noted some confusion over the rules for minimum retention scores (MRS) in determining whether a candidate receives credit for having passed parts of the test. As explained in the instructions to Form 2587, if an individual taking all four parts of the exam passes one or two parts, he or she must achieve the MRS on each part(s) failed in order to receive credit for the part(s) passed. If the candidate passes three out of the four parts, however, he or she does not have to meet the MRS on the one part failed. A candidate taking fewer than four parts of the exam must achieve the MRS on each part taken in order to retain credit for any parts passed in a previous year.

### Form 8233 Errors Prompt Revision

The Compliance and Foreign Payments Divisions of the Office of the Assistant Commissioner (International) have noted that many agencies and universities fail to provide enough information on Form 8233, Exemption from Withholding on Compensation for Independent Personal Services for a Nonresident Alien, to enable the IRS to determine whether a NRA should be exempt under treaty provisions. In such cases, the forms are being returned for additional information. Among the most common errors are:

- Omission of complete name, address and taxpayer identification number.
- Failure to include a proper citation to a treaty provision.
- Citing treaty benefits to a country that is not a treaty partner of the U.S.
- Failure to submit statements required of NRA students, teachers/professors and researchers (Rev. Procs. 87-8, 87-9, 93-22 and 93-22A).
- Omission of permanent foreign address

Form 8233 is being revised to highlight areas where errors are frequently made and alert preparers to the need to provide complete information. The revision will also clarify what constitutes independent personal services versus dependent personal services, since there appears to be some confusion as to who has to file. Form 8233 should be completed for any NRA who wishes to claim an exemption from withholding on compensation for personal services based on treaty benefits. The revised version of Form 8233 is expected to be available in October 1996.

The Internal Revenue Code provides that wages (in an employee capacity) paid to a nonresident alien are generally subject to the "normal" Federal Income Tax provisions under IRC section 3402. Other payments of

compensation for services are covered by IRC section 1441, which generally provides for a flat 30 percent rate. In the case of certain scholarships, fellowships, etc., the rate of withholding is reduced to 14 percent. However, treaty provisions in effect with some countries override the Code and exempt certain NRAs from withholding under certain circumstances.

Withholding agents should pay particular attention to the type of visa that the NRA received. Some types of visas do not allow a NRA to work while in the U.S. In addition, the NRA may be in the country beyond the period of time for which the treaty grants an exemption. This is especially true of graduate students, unless they entered the U.S. under a graduate program.

Please note also that some treaties allow an exemption for withholding only if the individual is receiving compensation from a foreign resident.

# U.S. Employers Can Avoid Foreign Social Security Taxes

U.S. Companies that do business abroad save hundreds of millions of dollars in foreign Social Security Taxes each year under agreements negotiated by the SSA. Currently, the U.S. has bilateral Social Security (totalization) agreements in force with 17 countries, including Canada and virtually all of Western Europe — Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

The agreements reduce business costs by eliminating dual Social Security coverage and taxation. Dual coverage occurs when a worker from one country works in another country and is required to pay Social Security taxes to both countries on the same earnings. Each agreement includes rules that assign a worker's coverage to only one country.

Under a typical agreement, if an American employer transfers a U.S. citizen or resident to a job in another country for five years or less, the employer and worker will continue to pay U.S. Social Security taxes and be exempt from taxes in the host country. If, however, a U.S. citizen or resident is sent to the other country for more than five years, or is hired locally in the other country, the employer and worker will pay Social Security taxes only to the host country.

Employers and workers who are exempt from U.S. or foreign Social Security taxes under an agreement must document their exemption by obtaining a certificate of coverage from the country that provides coverage. For example, if a U.S. worker is on a temporary assignment to the United Kingdom, the employer would need to obtain a certificate of coverage from SSA to prove to U.K. authorities that the employer and the worker are exempt from U.K. Social Security contributions. In 1995, SSA issued more than 25.000 certificates for U.S. workers on overseas assignments, saving them and their employers an estimated \$500 million annually in foreign Social Security contributions.

SSA publishes pamphlets about the agreements and includes instructions for employers to request certificates of coverage. To obtain a pamphlet, or get more details on a specific agreement, write to the Social Security Administration, Office of International Policy, P.O. Box 17741, Baltimore, MD 21235. The pamphlets are also available on the Internet through the World Wide Web at http://www.ssa.gov/international/inter\_intro.html. If you prefer, you may call SSA's Office of International Policy at (410)965-3548 or 965-3544.

#### U.S.-German Social Security Agreement Amended

A new Social Security agreement between the U.S. and Germany entered into force on May 1, 1996, amending an earlier agreement that has been in force since December 1, 1979.

The new agreement revises the temporary transfer rule in the U.S.-German agreement to bring it into conformity with other U.S. Social Security agreements. Unlike similar provisions in other U.S. agreements, the original agreement with Germany included no specific time limit on the exception provided if an employer in one country sends an employee to work in the other country for a temporary period. The new agreement revises the temporary transfer rule in the U.S.-German agreement so that it explicitly applies only to transfers that are expected to last five years or less.

The supplementary agreement also expands the scope of the German tax exemption available to workers (and their employers) who are sent from the U.S. to work temporarily in Germany. Previously, these workers and employers were exempt only from the German Social Security tax that finances retirement, survivors and disability pensions. Under the supplementary agreement, workers and employers who qualify for a German Social Security tax exemption are also exempt from the German contributions for health/cash sickness insurance and the long-term nursing care program that became effective in Germany in 1995.

#### Managers' Settlement Authority Increased

The IRS recently clarified and extended the authority of Examination case managers to help ensure that tax disputes are resolved at the lowest possible level. In making the announcement, IRS Commissioner Margaret Richardson noted that, "Greater settlement

authority at the exam level means less time and expense for both the taxpayer and the government in getting to the correct tax liability."

Managers may use a previous Appeals settlement with a particular taxpayer or another, directly involved taxpayer in a Coordinated Examination Program case to resolve the same issue in another tax year. Earlier IRS initiatives raised the percentage of CEP cases agreed to at the Exam level from 29 percent in FY-1990 to 75 percent in FY-1994. This action further increases that rate.

Also, Exam managers may now use Appeals settlement guidelines to resolve certain coordinated issues in the Industry Specialization Program and International Field Assistance Specialization Program. Appropriate ISP or IFASP coordinators would review proposed settlements to ensure consistency and uniformity.

## Tax Relief for Troops in Bosnia and their Spouses

Members of the U.S. Armed Forces and support personnel serving in the peace-keeping efforts in the former Yugoslavia (Bosnia, Herzegovina, Croatia, and Macedonia) will not have to file their 1995 individual income tax returns until at least 180 days after they depart from that area. No interest or penalties will be charged during this period on any tax due for 1995, under the recently enacted legislation.

The IRS will also suspend all tax return examinations and actions to collect back taxes owed by these taxpayers for years prior to 1995 until at least 180 days after the taxpayer leaves the peace-keeping area. During this time no interest or penalties will be added to the tax due.

The additional time for filing and paying taxes is also applicable to U.S. military personnel performing support services in areas

outside the U.S. and away from their permanent duty stations as part of the peace-keeping efforts in Bosnia and Herzegovina, and Croatia.

Military pay received by enlisted personnel while serving in these peace-keeping efforts is exempt from federal income tax. For commissioned officers, the new law excludes up to the "maximum enlisted amount" per month, currently \$4,104.80 plus certain special pay. This amount was \$500 per month under prior law.

These relief provisions apply not only to members of the U.S. Armed Forces and support personnel participating in these peace-keeping efforts, but also to their spouses. The new legislation is generally effective on November 21, 1995. The IRS expects to issue further guidance on tax relief under the new law in the near future.

## IRS Foreign Post Closures and Realignments

In line with our efforts to maintain presence abroad at reduced costs, we are going ahead with plans to close the Riyadh post after the current filing season — June 30th. Taxpayers residing in countries formerly serviced by the Riyadh post will be serviced from IRS offices in Bonn, London, Paris, Rome and Singapore (see listing below).

In addition, the former Nassau, Bahamas, post has been consolidated into the IRS post headquartered in Mexico City. As previously announced the IRS posts serving South America were consolidated into a new post headquartered in Santiago, Chile. Taxpayers residing in the island nations of the Caribbean basin should call the IRS office in Puerto Rico on (787)766-5040 (not a toll-free number) for tax help. Taxpayers residing in the Bahamas and the U.S. Virgin Islands will continue to use the IRS toll-free number — (800)829-1040 — for assistance.

Our updated list of overseas post jurisdictions:

#### BONN, Germany — Margaret Lullo, RSR

Germany, Austria, Hungary, Netherlands, Romania, Poland, Luxembourg, Czech Republic, Slovak Republic, Estonia, Latvia, Lithuania, Former Soviet Republics (Armenia, Azerbijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan), Lebanon, Iraq, Qatar, Syria, Iran, Yemen.

#### LONDON, England — Stan Beesley, RSR

United Kingdom, Denmark, Ireland, Finland, Norway, Sweden, Iceland, Angola, Botswana, Eritrea, Ethiopia, Kenya, Lesotho, Malawi, Mozambique, Nambia, South Africa, Sierra Leone, Somalia, St. Helena, Sudan, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe.

#### **MEXICO CITY, Mexico — Dan Dietz, RSR**

Mexico, Guatemala, Belize, El Salvador, Nicaragua, Costa Rica, Honduras, Anguilla, Antigua & Barbuda, Aruba, Bahamas, Barbados, Bermuda, British Virgin Islands, Cayman Islands, Dominica, Dominican Republic, Grenada, Guadeloupe, Haiti, Jamaica, Martinique, Montserrat, Netherland Antilles (Curacao, Bonaire, St. Maarteen & Saba), St. Barthelemy (St. Barts), St. Christopher (St. Kitts) and Nevis, St. Lucia, St. Martin, St. Vincent and Grenadines, Trinidad & Tobago, Turks & Caicos.

## OTTAWA, Canada — Pat Fong, RSR Canada

#### PARIS, France — Fred Pablo, RSR

France, Spain, Portugal, Switzerland, Algeria, Liechtenstein, Morocco, Monaco, Belgium, Gibraltar, Andorra, Tunisia, Benin, Burkina Faso, Burundi, Cameroon, Cape Verde, Central Africa Republic, Chad, Comoros, Congo, Djibouti, Egypt, Equatorial Guinea, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Libya, Madacascar, Mali, Mauritania, Mauritius, Mayotte, Niger, Nigeria, Reunion, Rwanda, Sao Tome & Principe, Seychelles, Senegal, Togo, Zaire, Western Sahara.

#### ROME, Italy — Larry LeGrand, RSR

Italy, Malta, Croatia, Slovenia, Bosnia-Herzegovina, Serbia/Montenegro, The Former Yugoslavia Republic of Macedonia, Bulgaria, Israel, Cyprus, Greece, Albania, San Marino, Bahrain, Jordan, Kuwait, Oman, Saudi Arabia, Turkey, United Arab Emirates.

#### SANTIAGO, Chile — Fred Dulas, RSR

Argentina, Bolivia, Brazil, Chile, Columbia, Ecuador, French Guiana, Guyana, Panama, Paraguay, Peru, Surinam, Uruguay, Venezuela.

### SINGAPORE, Singapore — Shirley Sherwood, RSR

Malaysia, Singapore, Thailand, Vietnam, Indonesia, Burma, Bangladesh, India, Sri Lanka, Nepal, Bhutan, Brunei, Cambodia, Pakistan, Afghanistan.

#### SYDNEY, Australia — Vivian Simon, RSR

Australia, New Zealand, Nauru, Fiji, Vanuatu, Papua New Guinea, Western Samoa, and all areas south of the equator and west of the 130th degree of longitude.

#### TOKYO, Japan — Dennis Tsujimoto, RSR

Japan, Korea, China, Philippines, Hong Kong, Marshall Islands, Taiwan, Federated States of Micronesia, Mongolia.

#### **TAX FORUM**

Publication 1045, Information for Tax Practitioners, is mailed annually to practitioners who order it by submitting Form 3975, Tax Practitioner Annual Application, to the IRS Distribution Center. This mailout is not automatic, you must resubmit Form 3975 each year or you will not receive Publication 1045. The package includes blanks for tax forms, instructions, and publications. It also contains information on how to order forms and how to be placed on the mailing list, as well as IRS regulations relating to tax return preparers. Requests should be sent to Eastern Area Distribution Center, P.O. Box 27322, Richmond, VA 23261, USA. Please note that the only way to get Package X is through the order form, 3975, in Publication 1045.

**International Tax Forum**, a quarterly publication of the office of the Assistant Commissioner (International), is available on request by writing to: Internal Revenue Service, Assistant Commissioner (International), Attn: CP:IN:D:CS:PAO, Prom. Level, 950 L'Enfant Plaza SW, Washington, DC 20024, USA.

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